



THE US-CHINA BUSINESS COUNCIL

美中貿易全國委員會

Understanding the US-China Balance of Trade

The US trade deficit with China often assumes center stage in discussions of the US-China commercial relationship, but the deficit is neither the most important barometer of US economic health nor the best measure of the benefits the US gains from trade. Furthermore, the size of the imbalance is often overstated and analysis tends to understate US exports to China. In 2003, the US Department of Commerce (USDOC) put the bilateral deficit at \$124 billion. (This figure represents the bilateral US trade deficit with China based on US exports' free-alongside-ship (FAS) value and US imports' general Customs value.) Economists have argued that a more accurate figure would be \$109.8 billion.

The United States Reaps Important Benefits from Two-way Trade

China as an export market

China is one of the fastest-growing US export markets. Annual US exports to China have increased seven-fold since 1990, reaching \$28.4 billion in 2003. Major US exports to China include power generation equipment, electrical machinery, aircraft, and medical equipment. US companies in many sectors face mature markets at home and look to the Chinese market to grow and remain competitive globally.

US consumers

US consumers benefit from the ability to purchase low-cost imports from China, including footwear, apparel, and, increasingly, electrical machinery and equipment.

US Measurements Inflate the Bilateral Trade Deficit

Measurements of exports and imports

As do other countries, the United States measures exports and imports on different bases. US exports typically are calculated on an FAS basis, US imports are measured using a cost, insurance, and freight (CIF) basis. The FAS value does not include loading, insurance, and freight costs. If all export and import values are converted to a common free-on-board (FOB) basis, US exports would be adjusted up by 1 percent, and US imports adjusted down by 10 percent, according to a 2001 report by California-based economists Lawrence Lau and K. C. Fung.

Entrepôt trade through Hong Kong

USDOC statistics, commonly used in the United States to measure bilateral merchandise trade, overstate the 2003 US bilateral trade deficit with China by roughly 13 percent because of the way entrepot trade through Hong Kong is calculated. (Entrepot trade refers to goods shipped from one economy to another through a third economy for further processing or assembly.) USDOC counts the full value of Chinese goods re-exported by Hong Kong as PRC exports, even though roughly 25 percent of the value of the goods originating in China is added in Hong Kong. The United States makes the same error in calculating our own exports to China. All US goods exported to Hong Kong are counted as exports to Hong Kong, even those that are re-exported to China.

Taking Hong Kong trade figures into account allows for a more accurate measure of US imports from China. Hong Kong re-exported \$33.4 billion in Chinese goods to the United States in 2003. Subtracting the 25.5 percent value added in Hong Kong of \$8.5 billion from the value of US imports from China results in an adjusted figure of \$143.9 billion for US imports from China.

In 2003, Hong Kong re-exported \$6.2 billion worth of US goods to China. Adding this amount, less the value added in Hong Kong (\$580 million), to the value of US direct exports to China (\$28.4 billion) gives an adjusted figure for US exports to China of \$34.1 billion.

Services trade

The bilateral deficit falls further when trade in services is counted because the United States has enjoyed a growing surplus in services trade with China for much of the past decade. US services exports grew 7.5 percent in 2002, to \$6.1 billion, more than triple the trade in services surplus with China in 1992, the first year for which data are available. The US services trade surplus, roughly \$1.9 billion in 2002, is likely to rise as China's World Trade Organization entry generates opportunities for US service providers. Services, which already account for 78.8 percent of the US economy, will account for much of the future economic growth in the United States.

Imports from China Are Not Direct Substitutes for US-Made Goods

According to a 1999 Institute for International Economics study, 90 percent of US imports from China are substitutes for US imports from other low-wage economies, largely in East

The United States Reaps Important Benefits from Two-Way Trade

- China is one of the United States's fastest-growing export markets.
- US consumers benefit from the ability to purchase low-cost imports from China.

US measurements inflate the bilateral trade deficit

- USDOC counts entrepot trade through Hong Kong differently for exports and imports.
- The United States measures exports and imports on different bases.
- Merchandise trade figures tell only part of the story—they exclude trade in services.

Imports from China are not direct substitutes for US-made goods.

and Southeast Asia. Top US imports from China are low-tech electrical machinery, toys, footwear, and apparel.

The relocation of Asian production facilities affects the US deficit.

Relocation of Asian Factories Affects the US Deficit

PRC trade and investment reforms initiated in the late 1970s made China a more attractive place for foreign investment than neighboring economies such as Taiwan and South Korea. Multinational corporations thus relocated many of their processing ventures to China, and the bilateral trade deficit with Hong Kong, Singapore, South Korea, and Taiwan declined while the deficit with China climbed. A second large-scale shift of production facilities from Taiwan and Japan to China is under way, in fields ranging from appliances and textiles to semiconductors. This development could further alter the composition of the US trade deficit with countries in the region.

Table: Adjusted US Trade Flows and Deficit with China (\$ billion)

Year	Department of Commerce Figures			Adjusted Figures		
	Exports	Imports	Trade Deficit	Exports	Imports	Trade Deficit
1999	13.1	81.8	68.7	18.1	73.6	55.5
2000	16.3	100.1	83.8	21.9	90.7	68.8
2001	19.2	102.3	83.0	25.3	93.7	68.5
2002	22.1	125.2	103.1	27.9	116.4	88.5
2003	28.4	152.4	124	34.1	143.9	109.8

Source: Nicholas Lardy, *China in the World Economy*, (c)1994 Institute for International Economics, with updated information from Nicholas Lardy (Institute for International Economics) 1999-2004.

Note: Imports are based on US Customs Service general customs value--the actual cost of the goods, excluding import duties, freight, insurance, and other charges.

**Copyright 1996-2008 by the US-China Business Council
All rights reserved.**

Last Updated: 3-Aug-04